

2 June 2020

Consumer Non-cyclical | Rubber Products

Supermax Corp (SUCB MK)

Buy (Maintained)

OBM = Lightning In a Bottle! Stay BUY

Target Price (Return): MYR10.50 (32.1%)
 Price: MYR7.95
 Market Cap: USD2,378m
 Avg Daily Turnover (MYR/USD) 70.3m/16.2m

- Maintain BUY, higher DCF-derived MYR10.50 TP from MYR6.66, 32% upside and 1% yield.** We organised a webinar with Supermax. Three key takeaways are that lead time has surged, exposure to nitrile gloves has increased and products sold via its original brand manufacturer (OBM) business have inched up to 55%. We increase our TP after assuming better ASP and higher nitrile gloves exposure. Our TP implies FY21 forward P/E of 31.2x (20% discount vs sector average). This is justified due to lower market cap/liquidity.
- Demand-supply imbalance continues...** From the webinar with Supermax, we gather that gloves demand has continued to increase in the past 1-2 weeks. Its latest lead time is now 12 months (c.10 days ago: 10 months). The company's orders are secured up to Jun 2021. The utilisation rate is now almost full at 90-95% as compared to the normal level of 80-85% before COVID-19.
- Higher exposure to nitrile gloves, now at 63%.** For 9MFY20, Supermax's sales breakdown has seen higher exposure to nitrile gloves. The ratio of nitrile to latex is now at 63:37 vs the historical 45:55. We are positive on this as nitrile gloves margins have tended to be more stable in the past. The price for nitrile gloves is higher as it is sold to developed countries.
- OBM = Lightning in a bottle!** After many years of investing and persisting with its OBM model, Supermax is reaping the fruits of success now. We expect its ASP increase to be above industry as the company captures higher ASPs on both the manufacturing and distribution levels. Additionally, the company has tactically increased its OBM exposure. Before COVID-19, OBM contributed about 40-50% of business volume. Post COVID-19, Supermax responded well by increasing its OBM exposure to 55%. This means that its margin should continue to expand for FY21-22.
- Best EBITDA margin in gloves industry in 1QCY20.** Note that the superior business model has proven itself in 3QFY20 earnings. During the quarter, Supermax's EBITDA margin of 25% is the highest historically for the company. More importantly, it is higher than its peers' EBITDA margins which range from 18.3% to 22.1%.
- BUY with a higher TP of MYR10.50.** We have increased our FY20-22F earnings by 8-62% after increasing ASP assumptions and higher nitrile gloves contribution. Our FY20F average ASP increase has been updated to 11% (previously 9%). In the near term, we expect Supermax's 4QFY20 net profit to surge 61% QoQ. In the long run, Supermax is a beneficiary of the long-term uptrend of gloves consumption globally at 8-10% annually (even without COVID-19).

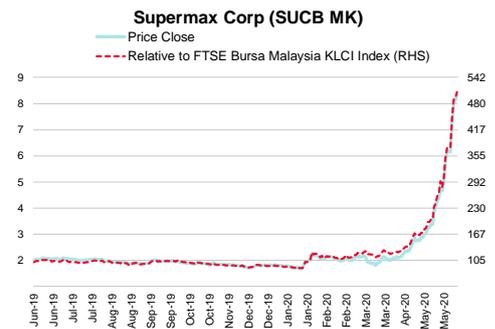
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	471.9	220.6	400.0	493.7	398.4
Relative	478.1	214.7	399.5	498.3	408.1
52-wk Price low/high (MYR)				1.30	7.95



Source: Bloomberg

Forecasts and Valuation	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
Total turnover (MYRm)	1,304	1,538	1,757	2,297	2,590
Recurring net profit (MYRm)	107	123	240	440	584
Recurring net profit growth (%)	-	15.5	94.5	83.7	32.8
Recurring P/E (x)	97.37	84.30	43.35	23.60	17.77
P/B (x)	10.3	9.2	8.0	6.5	5.2
P/CF (x)	58.61	44.18	24.20	17.12	14.49
Dividend Yield (%)	1.0	0.2	0.8	1.5	2.0
EV/EBITDA (x)	42.96	44.92	26.69	15.32	11.40
Return on average equity (%)	-	11.5	19.8	30.4	32.3
Net debt to equity (%)	28.5	19.2	net cash	net cash	net cash

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (MYR)	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
Malaysia	Recurring EPS	0.08	0.09	0.18	0.34	0.45
Consumer Non-cyclical	DPS	0.08	0.02	0.06	0.12	0.16
Supermax Corp	BVPS	0.78	0.86	0.99	1.23	1.54
SUCB MK	Return on average equity (%)	-	11.5	19.8	30.4	32.3
Buy						
	Valuation metrics	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
	Recurring P/E (x)	97.37	84.30	43.35	23.60	17.77
	P/B (x)	10.3	9.2	8.0	6.5	5.2
	FCF Yield (%)	1.1	1.2	2.7	4.4	5.5
	Dividend Yield (%)	1.0	0.2	0.8	1.5	2.0
	EV/EBITDA (x)	42.96	44.92	26.69	15.32	11.40
	EV/EBIT (x)	51.83	55.77	33.79	17.83	12.93
	Income statement (MYRm)	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
	Total turnover	1,304	1,538	1,757	2,297	2,590
	Gross profit	430	510	732	1,046	1,255
	EBITDA	244	232	381	643	829
	Depreciation and amortisation	(42)	(45)	(80)	(91)	(98)
	Operating profit	202	187	301	552	730
	Net interest	(14)	(20)	(4)	3	11
	Pre-tax profit	162	172	315	578	768
	Taxation	(52)	(49)	(74)	(136)	(180)
	Reported net profit	107	123	240	440	584
	Recurring net profit	107	123	240	440	584
	Cash flow (MYRm)	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
	Change in working capital	57	31	104	77	43
	Cash flow from operations	177	235	429	607	717
	Capex	(59)	(112)	(150)	(150)	(150)
	Cash flow from investing activities	(55)	(112)	(143)	(136)	(129)
	Dividends paid	(76)	(33)	(72)	(132)	(175)
	Cash flow from financing activities	(126)	(104)	(40)	(111)	(214)
	Cash at beginning of period	156	145	174	430	799
	Net change in cash	(4)	19	246	360	374
	Ending balance cash	145	174	430	799	1,184
	Balance sheet (MYRm)	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
	Total cash and equivalents	145	174	430	799	1,184
	Tangible fixed assets	900	969	1,018	1,068	1,121
	Total investments	197	208	208	208	208
	Total assets	1,700	1,843	2,138	2,631	3,094
	Short-term debt	374	331	294	336	327
	Total long-term debt	62	61	129	121	114
	Total liabilities	677	708	835	1,018	1,071
	Total equity	1,023	1,134	1,303	1,613	2,023
	Total liabilities & equity	1,700	1,843	2,138	2,631	3,094
	Key metrics	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
	Revenue growth (%)	0.0	17.9	14.2	30.7	12.8
	Recurrent EPS growth (%)	0.0	15.5	94.5	83.7	32.8
	Gross margin (%)	33.0	33.2	41.7	45.5	48.5
	Operating EBITDA margin (%)	18.7	15.1	21.7	28.0	32.0
	Net profit margin (%)	8.2	8.0	13.6	19.2	22.6
	Capex/sales (%)	4.5	7.3	8.5	6.5	5.8
	Interest cover (x)	14.5	9.5	26.1	51.5	73.9

Source: Company data, RHB

Valuation

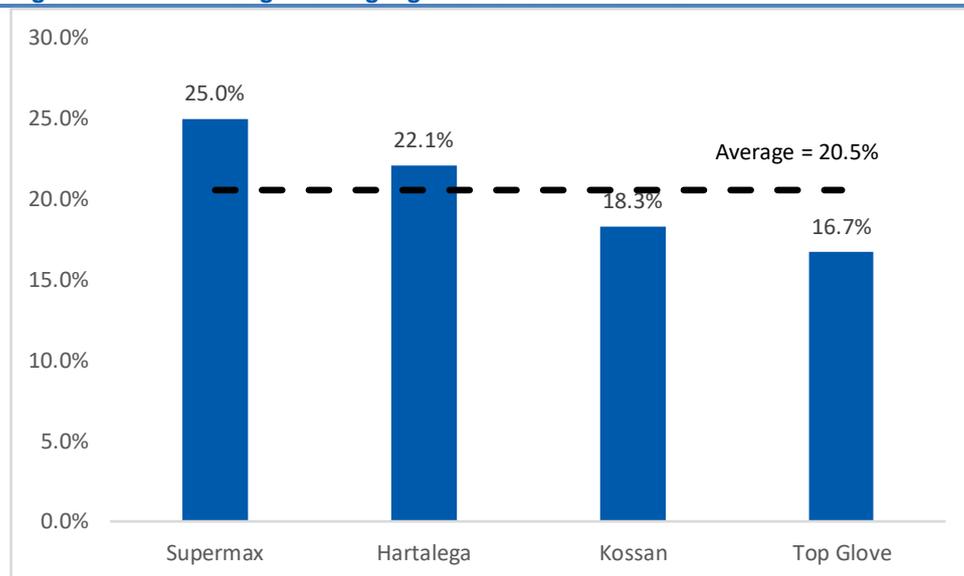
FCFF increased. In our DCF valuation, we have increased free cashflow to firm (FCFF) assumptions in line with better earnings prospects. This is driven by the better ASP outlook and higher nitrile gloves contribution. Our DCF-derived TP of MYR10.50 reflects forward P/E of 31.2x. This is also at a 20% discount against sector average, which we think is justified due to lower market cap/liquidity.

Figure 1: DCF valuation

FYE Dec (MYR m)	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	Terminal
CFO	605	717	681	763	821	838	891	953	991	1,021	
+ Interest (1 - Tax Rate)	(8)	(8)	(7)	(6)	(6)	(5)	(4)	(4)	(3)	(3)	
- capital expenditure	(150)	(150)	(150)	(150)	(150)	(150)	(150)	(150)	(150)	(150)	
Free cash flow to firm (FCFF)	447	559	524	606	665	683	737	799	838	868	22,615
Discount factor	0.92	0.85	0.78	0.72	0.66	0.61	0.56	0.51	0.47	0.43	0.43
PV of FCFF	411	473	408	435	438	414	411	411	396	377	9,832
Risk-free	4.0%										
Beta	0.81										
Cost of Equity	8.9%										
WACC	8.0%										
Terminal growth	4.0%										
Enterprise Value (MYR m)	14,008										
Cash	218										
- Debt	(473)										
Equity Value (MYR m)	13,754										
No of shares (m)	1309.90										
Fair Value (MYR)	10.50										

Source: RHB

Figure 2: EBITDA margin for Big 4 glove makers in 1QCY20



Source: Company data, RHB

Changes In Supply Chain Benefited OBM

OEM outperformed in market structure before COVID-19. Historically, before COVID-19, original equipment manufacturer (OEM) players tended to fetch better margins compared to OBM. This is due to the supply chain back then, in which manufacturers' ASP made up only c.25% of the final value of price to consumers. The remaining 75% is the price mark-up made by agents, importers and dealers.

Under such market conditions, OEM's margin outperforms as the way to increase profit is through higher efficiency by maximising utilisation rate and volume produced. With a cost pass-through mechanism in place, the focus is to maximise volume produced to maximise profit. Back then, Supermax's margin was lower as the distribution side has to carry on inventory holding, marketing and advertising costs. This is understandable as Supermax has its own brand distribution centres in eight countries, including the US, Brazil, Canada, Ireland, UK, Hong Kong, Singapore and Japan.

However, OBM outperformed after COVID-19. As COVID-19 spread across the world, demand for gloves has spiked. Recall on 3 Mar, World Health Organisation (WHO) Director General Dr Tedros Adhanom Ghebreyesus said that the industry must increase personal protective equipment (PPE) production by 40% to meet rising global demand to protect healthcare workers from COVID-19. We estimate gloves demand (which is an essential part of PPE) to have increased by 50% over the past 2-3 months. On the supply side, expansion has slowed down due to the Movement Control Order (MCO). At best, the industry can only expand the supply by 10%. The huge demand-supply imbalance caused major reactions by the health ministries of various countries to get their major dealers to secure large volumes from gloves companies. Under such a market, OEM players do enjoy higher ASPs. However, OBM players with manufacturing capability enjoy the highest margin as the ASP increase is seen up to the consumer level. In countries in which Supermax has OBM exposure, it has basically has taken up the whole value chain (25% as OEM + 75% as distributor). Hence, OBM margin outperformed OEM in the extreme demand situation.

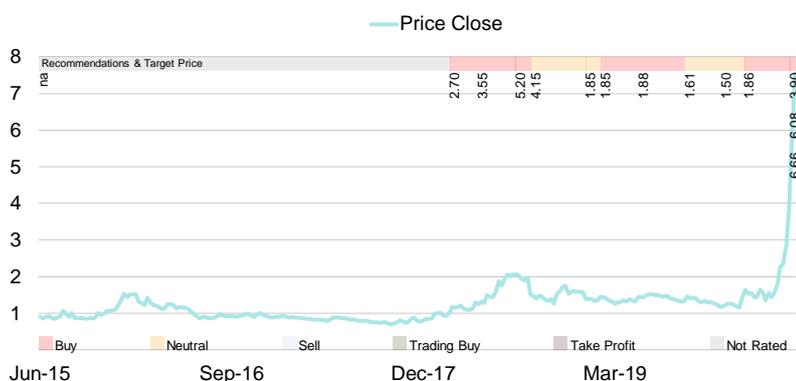
Key assumptions

Figure 3: Key assumptions

Key Assumptions	FY20F	FY21F	FY22F
Installed Capacity (m ppa)	26,000	29,000	32,000
Average USD/MYR	4.28	4.28	4.28
Utilisation Rate	80%	90%	90%

Source: RHB

Recommendation Chart



Date	Recommendation	Target Price	Price
2020-05-22	Buy	6.66	5.75
2020-05-21	Buy	6.08	5.40
2020-05-13	Buy	3.90	3.60
2020-03-15	Buy	1.86	1.71
2019-11-29	Neutral	1.50	1.34
2019-09-03	Neutral	1.61	1.46
2019-07-19	Buy	1.88	1.62
2019-02-13	Buy	1.85	1.61
2019-01-08	Neutral	1.85	1.62
2018-08-30	Neutral	4.15	1.66
2018-07-23	Buy	5.20	2.18

Source: RHB, Bloomberg

Source: RHB, Bloomberg

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